No. 14,695

United States Court of Appeals

For the Ninth Circuit

MID-STATES INSURANCE COMPANY, a corporation, and THE ANGLO CALIFORNIA NATIONAL BANK OF SAN FRANCISCO,

Appellants,

vs.

AMERICAN FIDELITY AND CASUALTY COMPANY, INC., a corporation, AMERICAN PLAN CORPORATION, a corporation, MARK HART, JOSEPH LOTZ, RALPH L. SMEAD and L. SUDEKUM,

Appellees.

Appeal from the United States District Court for the Northern District of California, Southern Division.

BRIEF FOR APPELLANT THE ANGLO CALIFORNIA NATIONAL BANK OF SAN FRANCISCO.

SEVERSON, MCCALLUM & DAVIS,
ALMON B. MCCALLUM,
NATHAN R. BERKE,
38 Sansome Street, San Francisco 4, California,
Attorneys for Appellant, The Anglo California National Bank of San Francisco.

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A. STATEMENT OF THE PLEADINGS AND FACTS SUPPORTING JURISDICTION.

This is an appeal from a judgment of the United States District Court for the Northern District of

California, Southern Division (T. 141)[1], rendered in favor of the appellees in two actions numbered 31,311 and 31,496 in the said District Court.

Action No. 31,311 (referred to as the "Bank Case") was brought by Mid-States Insurance Company, an Illinois corporation, against Anglo Bank, a national banking association (T. 3), praying judgment for $99,021.10 in connection with 9 checks payable to Mid-States, endorsed by the appellees Joseph Lotz and Ralph Smead and deposited by them in Lotz' Trust Account with Anglo Bank. In this same action, Anglo Bank filed a third party complaint against the appellees (T. 65).

Action No. 31,496 was commenced by Mid-States against American Fidelity and Casualty Company, a Virginia corporation, The American Plan Corporation, a New York corporation, Mark Hart, L. Sudekum and John Will, residents of New York, and Joseph Lotz and Ralph Smead, residents of California (T. 8). In this action Anglo Bank filed a complaint in intervention against the appellees (T. 50).

Subsequently Anglo Bank moved to consolidate both actions for trial and the District Court ruled that the issues presented in the complaint of Mid-States in Action No. 31,311, dealing with the authority of Joseph Lotz to endorse checks payable to Mid-States, be tried separately, and that the issues raised by the third party complaint of Anglo Bank be tried with Action No. 31,496.

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[1]References to the printed transcript of record are designated "T.".

In both actions Anglo Bank prayed for judgment against the appellees for all sums that might be adjudged against Anglo Bank in favor of Mid-States.

On December 29, 1953, in action 31,311, judgment was entered for Mid-States against Anglo Bank in the sum of $37,500.00.

The opinion of the Court below, decreeing that Anglo Bank take nothing by its complaint in intervention or by its third party complaint was issued on October 11, 1954 (T. 97), and the judgment pursuant thereto was entered on December 17, 1954 (T. 141). On December 27, 1954, appellants filed a motion for new trial, for modification of findings of fact and conclusions of law, and to alter and amend judgment (T. 142) which was denied on January 24, 1955 (T. 157). Notice of appeal to this Court was filed on February 7, 1955 (T. 157).

Jurisdiction of this Court is founded upon U. S. Code Title 28, §1291 which gives this Court jurisdiction over appeals from all final decisions of the District Court of the United States.

B. STATEMENT OF THE CASE.

1. Facts.

Mid-States and American Fidelity are insurance companies writing automobile insurance. American Plan is the manager of American Fidelity. Mr. Lotz was the general agent in California for both Mid-States and American Fidelity having been appointed as such by Mid-States in May, 1947 (T. 176), and by

American Fidelity in November, 1950. Mr. Smead was general manager for Mr. Lotz at his office in Oakland. In August, 1951, American Plan appointed Mr. Smead its representative in connection with the payment of monies owing by Mr. Lotz to American Fidelity and gave him full authority regarding the financial affairs of Mr. Lotz. In January, 1952, American Plan employed Mr. Smead and in June or July, 1952, appointed him as its Pacific Coast Manager (T. 818, 901). Mr. Hart is President and Messrs. Sudekum and Will officials of American Plan.

Mr. Lotz' contracts with American Fidelity and Mid-States were substantially the same in principle. Both authorized him to write insurance and collect premiums, and each required him to report daily the insurance written and to pay the premiums within a stated period. The arrangements are known as retrospective plans because Mr. Lotz' final participation or commissions depended upon the loss experience of his writings.

During the year, 1950, Mr. Lotz' average monthly premium volume with Mid-States was approximately $14,000.00—$15,000.00 per month (T. 188). After his appointment in November, 1950, as agent for American Fidelity, Mr. Lotz wrote most of his business in that company.

By August, 1951, Mr. Lotz owed American Fidelity approximately $247,000.00 and Mid-States approximately $30,000.00 for premiums. Because of this, Mr. Hart became concerned over Mr. Lotz' financial condition and called him to New York to discuss the matter.

About August 10, 1951, Messrs. Lotz and Smead met with Messrs. Hart, Sudekum and Will in New York. At this meeting they discussed Mr. Lotz' indebtedness, his assets, how the debt owing American Fidelity could be paid, and the writing of future business by Lotz in Mid-States.

Following this meeting, Mr. Smead returned to Oakland and Mr. Lotz went to Chicago where he received a new contract from Mid-States eventually dated September 1, 1951. This new contract, unlike the earlier one, specifically provided that premiums collected by Mr. Lotz for Mid-States were trust funds.

After August 10, 1951, practically all insurance written by Mr. Lotz was written in Mid-States.

With the return to Oakland of Messrs. Lotz and Smead following their meeting with Mr. Hart in New York, there commenced a concerted drive to obtain funds to pay to American Fidelity.

Shortly after the New York meeting Messrs. Hart, Lotz and Smead learned that Public Service Insurance Company wished to give up some of its writings and on August 16, 17 and 18 they discussed the possibility of Lotz taking over this insurance and rewriting it with Mid-States (T. 443, 444).

On August 20, 1951, Messrs. Hart and Feller arrived in Oakland (T. 445), requested Mr. Smead to call Public Service to make sure they could take over the block of business under discussion (T. 447), and on the evening of that day an arrangement was made with Public Service whereby Lotz would rewrite in Mid-States the insurance being cancelled by Public

Service and receive from Public Service approximately $150,000.00 in premiums less a 25% commission to be paid to Russell and Bond (T. 849).

Two days later on August 22, 1951, Mr. Lotz and American Fidelity and American Plan entered into a written agreement (T. 458) providing as follows:

> "The Manager (American Plan) hereby appoints Ralph L. Smead as its representative and Lotz agrees that the said representative shall have full authority over the finances of the company (American Fidelity) and in connection with the matters referred to herein subject to instructions of the Manager (American Plan)."

and providing further that (T. 457):

> "commencing immediately all premiums received by Lotz will be deposited directly to the account of the Company (American Fidelity) at the Central Bank, Oakland."

About the same time Mr. Hart gave Mr. Smead a letter dated August 17, 1951 (T. 465), providing:

> "Under even date memorandum of agreement has been executed by Joseph Lotz which in part stipulates that you will serve as the representative of American Plan Corporation with respect to the ultimate liquidation of all monies referred to in Paragraphs 1 and 2 ($247,000.00 owing by Lotz to American Fidelity (T. 456)) in said agreement.
>
> As the representative of this corporation you have full authority to deposit to the account of The American Fidelity and Casualty Company at the Central Bank in Oakland all monies received by Lotz . . . You are to have full and supreme au-

thority regarding financial affairs of Joseph Lotz, subject to instructions that may be transmitted to you from time to time by The American Plan Corporation, and in the event that you are prevented from performing your responsibility in any respect it will be your duty to notify immediately The American Plan Corporation.

In consideration of the proper performance of your duties as representative and in the event the items referred to in Paragraphs 1 and 2 of said agreement are completely liquidated by September 15, 1951, you are to receive a fee from us in the sum of $1,000.00."

Mr. Hart testified that he was interested in keeping Mr. Lotz in business (T. 904).

"A. Mr. Garrison, the insurance business is a gold fish bowl in that everybody inquires of other companies the status of agents. Mr. Lotz represented, in addition to Mid-States, life insurance companies and other insurance companies, and it was within the realm of possibility that he would apply to other companies for representation. *I was interested in keeping Mr. Lotz in business to collect our money,* and, among other things, I felt very sorry for Joe Lotz, who I have always considered to be extremely honest, and for that reason I wanted to be certain that our Treasurer told the truth, namely, that he was not delinquent and not in any way besmirch him or spoil his chances with any other company he may represent."

To keep Mr. Lotz in business it was necessary to make sure that no one would learn of his true financial condition and this was accomplished by a direc-

tive from Mr. Hart to his company on August 29, 1951.

> "In closing, you are instructed to inform anyone who inquires that Joe Lotz is up to date in his accounts with us and is not delinquent. This is not only extremely important, but it is actually true as Joe Lotz' May balance is technically paid and his June balance is not due until September 15, 1951" (T. 903).

The "technical payment" of the May balance was accomplished by a $38,000.00 loan to Lotz, and concerning this credit Mr. Hart testified:

> "Q. It did permit you to say to anyone if they were to inquire the account with Mr. Lotz was current?
>
> A. Yes, it did." (T. 903).

This planning to be able to report to anyone inquiring that Lotz was current at a time when Mr. Hart was concerned over Lotz' indebtedness to his company (T. 845), when Mr. Hart knew that Mr. Lotz could not pay his bills (T. 832), when Mr. Hart knew that Mr. Lotz was short of money (T. 859), and when Mr. Hart knew that Mr. Lotz was in need of borrowing money (T. 763), indicates the deliberate planning to keep Lotz in business long enough for Lotz to get possession of enough money to pay American Fidelity.

And while Mr. Hart was taking steps to keep Mr. Lotz in business by representing to others that he was current with American Fidelity, Mr. Hart was telling Mr. Lotz that he was delinquent and threatened him.

"Tomorrow is deadline with $190,000.00 due" (T. 482).

We are considerably disturbed over your failure to live up to agreement to liquidate our balances by September 15 (T. 484).

As frankly, am deeply concerned about the attitude that will be assumed by the company if their auditors uncover the delinquency (T. 487).

. . . will be obliged to take drastic steps immediately (T. 488).

. . . will take necessary action including advices to insurance department and other local authorities" (T. 488).

Such threats of "drastic steps" and "advices to insurance department and other local authorities" are not consistent with Mr. Hart's confessed feelings of feeling "very sorry for Joe Lotz" and of always considering him "to be extremely honest" and that he did not want his company "in any way to besmirch him or spoil his chances with any other company"; nor are the many statements that Mr. Lotz is delinquent and has failed to live up to his agreement consistent with informing anyone upon inquiry that Joe Lotz is current.

As soon as the arrangements with Public Service were made Messrs. Lotz and Smead, without having advised Mid-States, proceeded to rewrite the business with Mid-States. The first check they received from Public Service, which was received after Mr. Smead was appointed the agent of American Plan, was made payable to Joseph Lotz but Public Service stopped

payment on it and reissued the check payable to Mid-States. When Messrs. Lotz and Smead attempted to endorse and deposit checks payable to Mid-States the Central Bank requested a resolution from Mid-States authorizing Mr. Lotz to endorse its checks, and on August 27, 1951, Mr. Lotz wrote Mid-States as follows (T. 287):

> "Now, Gerald, this bank that I am doing business with (Central Bank) wants a resolution from your Board of Directors verifying that I have authority to endorse premium checks payable to Mid-States Insurance Company for deposit in my trustee account. I would appreciate it very much if you would send this authorization to me by return mail."

When the Public Service funds were not transferred to the account of American Fidelity, Mr. Hart on August 30, 1951, teletyped Messrs. Lotz and Smead inquiring about them (T. 476) and in reply Mr. Smead answered:

> "checks are all payable to Mid-States Insurance Company awaiting authorization required to deposit . . ."(T. 476).

to which Mr. Hart replied (T. 477):

> "Understood Public Service checks were to be made payable to Lotz. Has this procedure been changed?"

On this same day Messrs. Hart and Smead had a telephone conversation during which Mr. Smead told Mr. Hart they were expecting to receive $30,000.00 from Public Service and would pay it to American

Fidelity (T. 478), and on August 31, 1951, Mr. Hart teletyped Mr. Smead as follows:

> "Has check for $30,000.00 been deposited in AFC account yet?" (T. 478).

At the trial Mr. Hart testified (T. 805) concerning this $30,000.00 as follows:

> "Q. Did you know where the $30,000.00 was coming from?
>
> A. He was supposed to be in the process of collecting on behalf of Mid-States the premiums applicable to the Public Service business."

Consequently, the situation on August 31, 1951, was that Messrs. Hart, Lotz and Smead were planning to pay to American Fidelity premiums collected for Mid-States on the Public Service business but were unable to cash the checks at Central Bank because Lotz had no authority to endorse them.

The statements between them of the day before (August 30) as follows: "awaiting authorization required to deposit" (T. 477) and "if we do not receive authorization right away from them we can have reissued" (T. 477) illustrate their acute awareness of the lack of authority to endorse and of the problem of how to cash the Public Service checks payable to Mid-States and get possession of the funds.

To accomplish this purpose Mr. Lotz, on August 31, 1951, opened an account with Anglo California National Bank. At the trial he testified (T. 670):

> "Q. And at the time you opened the account, Mr. Lotz, you told the Bank you were going to

deposit checks made payable to the Mid-States Insurance Company, didn't you?

A. And other companies.

Q. And other companies, yes. And did the man from the Anglo Bank ask you if you had authority to endorse checks made payable to Mid-States Insurance Company?

A. Yes.

Q. And you told him you did, didn't you?

A. Yes."

Mr. Smead also testified that he told the Anglo Bank that Mr. Lotz had authority to endorse checks payable to Mid-States (T. 540).

"Q. Have you ever had any conversation with anyone from the Anglo Bank regarding Mr. Lotz' authority to endorse checks made payable to Mid-States Insurance Company?

A. Yes, sir.

* * * * * * *

The Court. Fix the time.

The Witness. In the early part of September, the exact date I don't know. I had a conversation in person and also I had telephone conversations from those.

* * * * * * *

Q. What was said?

A. The gentleman asked for, asked if Mr. Lotz had authority to deposit checks payable to insurance companies and I advised him that he did. On, I believe, the second occasion, or on a different occasion, they asked that—asked where that was contained, and I said it was in his general agency agreement with his companies. They asked for copies, or the original contracts, which

we promised to furnish—I believe Mr. Lotz was present at one or two of those conversations—which we did promise that we would furnish the bank."

And Mr. Hart admits that when Mr. Smead made these representations to Anglo Bank he was acting as his agent (T. 909).

"Q. And you have heard Mr. Smead so testify that on several occasions he told the Anglo Bank Mr. Lotz had authority to endorse checks made payable to Mid-States?

A. I heard that.

Q. Now, at the time Mr. Smead was telling the Anglo Bank that Mr. Lotz had authority to endorse checks, he was your agent, wasn't he, acting under this agreement of August 22nd?

A. Did you say Mr. Smead was our agent?

Q. Yes, sir.

A. Yes.

(Interruption by counsel.)

Q. I believe the answer to the last question was that at that time Mr. Smead was acting as your agent?

A. Yes."

About September 5, 1951, five days after the account was opened with Anglo Bank and before Messrs. Lotz and Smead endorsed and deposited any Mid-States checks therein, they received an answer from Mr. Hatfield explaining why Mid-States did not wish to give Mr. Lotz authority to endorse its checks, saying in part (T. 289):

"After being burned as we were on that occasion I am sure you will understand why we are most hesitant to grant such authority again."

Two days later, on September 7, 1951, Messrs. Lotz and Smead endorsed and deposited the first Public Service check with Anglo Bank payable to Mid-States in the amount of $5,547.25.

On the next day, September 8, 1951, understanding his lack of authority and accepting the refusal of Mid-States to authorize him to endorse its checks, Mr. Lotz, on the stationery of American Fidelity Co. wrote Mr. Hatfield in part as follows (T. 291):

> "Now, regarding my request for authority to endorse checks made payable to Mid-States Insurance Company we do not have very many like this, and those that we do have, we can have them made payable direct to me."

Two days later, on September 10, 1951, Mr. Hatfield again wrote Mr. Lotz stating (T. 291):

> "Under date of September 5th I wrote you on the subject of granting you authority to endorse premium checks which are made payable to Mid-States. I overlooked giving you the most important reason in that letter as to why we are reluctant to grant you the authority you requested. That reason is that under our blanket bond we do not have any protection if we grant authority to any person not on our payroll to endorse checks."

Mr. Smead knew at all times and while he was the agent of American Plan about the letters from Mid-States denying Mr. Lotz authority to endorse its checks. At the trial he testified (T. 538):

"Q. In other words, you knew that on or about August 27, Mr. Lotz wrote a letter to Mr. Hatfield requesting authority to endorse checks made payable to Mid-States?

A. Yes, sir.

Q. And you knew on or about September 5 that Mr. Hatfield had replied, refusing to give him such permission?

A. Yes, sir.

Q. And you knew also that a further following up of that letter was written by Mr. Hatfield about September 10?

A. Yes, sir."

And he knew about these letters during the period when he was telling the Anglo Bank that Mr. Lotz had authority to endorse checks payable to Mid-States (T. 541).

"Q. And over what period of time did these conversations extend?

A. Oh, a period of probably three weeks.

Q. Commencing with the first part of September?

A. Still—I would say from the, possibly, the tenth of September for a period of three weeks thereafter."

Neither Mr. Smead nor Mr. Lotz ever told the Anglo Bank about these letters from Mid-States denying Lotz authority to endorse its checks (T. 542 and T. 671). Instead they represented that Mr. Lotz did have such authority and endorsed the checks (T. 671).

"Q. After you received the two letters which I have just exhibited to you, you continued to

endorse checks payable to Mid-States and deposited them in the Anglo Bank, didn't you?

A. Yes."

During the period from September 7, 1951, to October 15, 1951, which is after Mr. Smead was appointed the agent of American Plan, and after Mid-States had refused Lotz authority to endorse its checks, and which corresponds with the period during which Mr. Smead was telling the Anglo Bank that Mr. Lotz did have authority to endorse checks payable to Mid-States (T. 541), Messrs. Smead and Lotz endorsed 5 checks from Public Service payable to Mid-States, totaling $94,136.69 and deposited them with the Anglo Bank. As the agent of American Plan Mr. Smead received instructions from Mr. Hart on the disposition of these funds (T. 547).

"Q. Did you ever discuss with anyone from the American Fidelity as to what you were doing with the funds from the Public Service when they came in?

A. Yes, sir.

Q. With whom did you have such a conversation?

A. With Mr. Hart.

Q. When did that conversation take place?

A. The conversation took place during his visit of August 20.

Q. What did he say?

A. And also I had conversations at later times. He instructed that the funds received from Public Service be deposited in Mr. Lotz' trustee account, then withdrawn payable to American Fidelity and Casualty Company and deposited in the

American Fidelity and Casualty account, Central Bank, in Oakland."

The instructions correspond with the written instructions given by Mr. Hart to Mr. Smead in the letter dated August 17, 1951 (T. 465).

After cashing the Public Service checks Messrs. Lotz and Smead paid the money to American Fidelity and advised Mr. Hart (T. 908), who testified:

"Q. Mr. Hart, when deposits were made in the American Fidelity account you were sent a copy of the deposit slip weren't you?

A. Yes.

* * * * * * *

Q. Did that come from Mr. Smead or Mr. Lotz, or did it come from the Bank?

A. I think it came from Mr. Smead."

To illustrate the payment of the Public Service monies to American Fidelity (which the trial Court found to be true, T. 130), Mr. Marks, called as a witness for American Fidelity, testified that on September 15, 1951, Mr. Lotz had $74,000.00 in the account with Anglo Bank of which $67,500.00 came from one Public Service check, and that on the day following, $60,000.00 was paid to American Fidelity (T. 1091). He also testified that on September 26, 1951, Mr. Lotz had $16,000.00 in the account with Anglo Bank after depositing a check from Public Service for $11,250.00 and that on that day $15,000.00 was paid to American Fidelity (T. 1092). Undeniably in these two payments alone, Messrs. Lotz and Smead paid at least $71,250.00 of Mid-States money to American Fidelity as a re-

sult of their endorsing these two Public Service checks payable to Mid-States. This substantiates Mr. Smead's testimony when he said:

> "However, I believe that the major portion of it was paid to the American Fidelity and Casualty Company" (T. 496).

And when he said:

> "I know that most all of the funds that were received by Lotz during that time were paid to the American Fidelity and Casualty Company" (T. 481).

Mr. Hart admittedly informed of the Public Service transaction, the manner in which the checks were written, and the problem of endorsing them must have known that the monies he was receiving were premiums for insurance written in other companies and Mr. Smead so advised him by teletype on September 14, 1951 (T. 482).

> "Q. Reads to Ralph Smead from Mark Hart: 'What is amount deposited today.
>
> Minute OK Will not make Deposit until after three o'clock today. Have approx. $5,000 regular and will make transfer from other funds.'
>
> A. Yes, sir. I recall this message.
>
> Q. What other funds did you mean when you used that expression?
>
> A. The 'regular' meant funds received for regular American Fidelity and Casualty premiums. Other funds would be from other companies.
>
> Q. Public Service or anyone?
>
> A. Public Service or anyone, yes, sir."

On the subject of his knowledge of the source of the monies paid to American Fidelity Mr. Hart testified (T. 922):

> "Q. And it had to come either from your collections or your sub-agents writing for you, or his commissions or his borrowings or somebody else's premiums?
>
> A. Came from various sources."

Mr. Hart also admits that his company had no right to participate in the Public Service monies (T. 877):

> "Q. Would it be true, then, that your company had no right to participate in any of the premiums paid in that insurance?
>
> A. Of course not."

In addition to the Public Service checks Messrs. Lotz and Smead endorsed and deposited 3 other checks payable to Mid-States totalling $3,284.65 (Find. XVIII, T. 136).

By the end of October, 1951, Lotz' indebtedness to American Fidelity was reduced from approximately $247,000.00 to approximately $61,000.00 (Find. III, T. 118, Find. XIV, T. 133). This reduction of approximately $186,000.00, paid in approximately 2½ months, and accompanied by threats from Mr. Hart of taking "drastic steps" (T. 488) and of taking "necessary action including advices to insurance department and other local authorities" (T. 488), was accomplished with premiums on insurance written in Mid-States and substantially with the Public Service monies which Messrs. Lotz and Smead received by representing to the Anglo Bank that Lotz had authority to

endorse the checks. The balance of $61,000 was paid by having Mid-States take over the insurance upon cancellation by American Fidelity.

In December, 1951, Messrs. Lotz and Smead told Mid-States that at the meeting in August in New York it was understood and agreed that in order to pay American Fidelity they would have to use premiums collected on insurance written in another company, that using Mid-States for this purpose was discussed, and gave written statements of the matters discussed to effect payment to American Fidelity (T. 253 and T. 653).

Upon receipt of these statements Mr. Titus, President of Mid-States, called Mr. Hart who came to Chicago in December, 1951, to discuss the matter. At the trial Mr. Hart testified about these statements as follows (T. 899):

> "Q. Well, didn't Mr. Titus tell you about them when you met him in Chicago at that meeting?
>
> A. He told me he had them."

After being told about these statements, and although testifying at the trial that he believed that Mr. Smead had deliberately told untruths about him and American Plan (T. 901), Mr. Hart, nevertheless, hired Mr. Smead in January, 1952, and six months later appointed him Pacific Coast Manager of American Plan (T. 902).

2. Questions Involved.

The questions involved in this case are as follows:

(1) Since Messrs. Lotz and Smead were the agents of American Plan and American Fidelity, are not American Plan and American Fidelity, as principals, responsible for the acts of their agents in falsely representing to Anglo Bank that Lotz had authority to endorse the checks payable to Mid-States?

(2) Are American Plan and American Fidelity entitled to enrich themselves and benefit by the false representations of their agents to the damage and injury of an innocent third party?

(3) Where the parties have agreed in writing by the agreement dated September 1, 1951, that premiums are collected as trust funds and the agent without knowledge of the principal violates the agreement can there be a "course of dealing" altering the written agreement?

(4) Can a party keep funds knowing that he is being paid with trust funds?

(5) What is required to prove a conspiracy?

C. SPECIFICATION OF ERRORS.

(1) Although the trial Court found (1) that Mr. Smead was the agent of American Plan (T. 131), (2) that Mr. Lotz represented and warranted to Anglo Bank that he had authority to endorse checks payable to Mid-States (T. 136), (3) that Anglo Bank believed that Mr. Lotz was authorized to endorse checks

payable to Mid-States (T. 137), (4) that the checks Mr. Lotz endorsed represented premiums on insurance written for Mid-States (T. 138), and the uncontradicted evidence showed (5) that Mr. Lotz had written asking Mid-States for authority to endorse its checks (T. 287) and in 2 separate letters was denied such authority (T. 289, T. 291), one of which he acknowledged (T. 291), (6) that Mr. Smead admitted he also represented to Anglo Bank that Mr. Lotz had authority to endorse Mid-States' checks even while knowing about the letters from Mid-States denying such authority (T. 540, 538, 541), and (7) that Mr. Hart testified that while Mr. Smead was making these representations to Anglo Bank he was his agent (T. 909), the trial Court held that Mr. Lotz believed he had authority to endorse Mid-States' checks and that neither he nor Mr. Smead intended to deceive the Anglo Bank (T. 139); notwithstanding that Messrs. Lotz and Smead endorsed and deposited the checks after actual receipt from Mid-States of letters denying Mr. Lotz authority to endorse its checks. It is respectfully submitted that where one has asked for authority to do a specific act and after being denied the authority nevertheless proceeds to perform the act, that it is error to find that such party believed "he had such authority and did not intend to deceive" (Find. XXIII, T. 139).

(2) Although the uncontradicted evidence showed that Messrs. Lotz and Smead endorsed and deposited checks payable to Mid-States with knowledge that they had no authority to do so, the trial Court found

that they were not guilty of any fraud or deceit (Find. XXIV, T. 139). It is respectfully submitted that where one represents and warrants he has authority to do a specific act knowing he has no authority that it is error to find such party not "guilty of any fraud or deceit."

(3) Although the trial Court found (1) that representations and warranties were made to the Anglo Bank concerning Lotz' authority to endorse Mid-States' checks (Find. XVIII, T. 136), (2) that Anglo Bank believed Mr. Lotz was authorized to endorse Mid-States' checks (Find. XX, T. 137), (3) that judgment was entered against Anglo Bank in the sum of $37,500.00 in connection with these checks endorsed by Messrs. Lotz and Smead, and (4) that the uncontroverted evidence showed these representations were made at times when Messrs. Lotz and Smead knew they had no such authority and after being specifically denied such authority, the trial Court held that the Anglo Bank had not been damaged (Find. XXIII, T. 138). It is respectfully submitted that where representations are made, believed and relied upon to one's damage, and are known to be false by the parties making them, that it is error to find that the party acting on such false representations "has not been damaged as a result of any act done, permitted, directed or suffered by" the party making such representations (T. 138).

(4) Although the trial Court found that the new agreement of September 1, 1951, between Mid-States and Mr. Lotz specifically provided that (1) all pre-

miums received by Mr. Lotz were to be held by him as trustee for Mid-States and were trust funds (Find. VI, T. 123), (2) that the Public Service checks were endorsed, cashed and paid to American Fidelity (Find. XIV, T. 130) in the main within 3 weeks after September 1, 1951 (Find. XVIII, T. 136), the trial Court held that "the course of dealing between Mid-States and Mr. Lotz was not altered after the execution" of the agreement of September 1, 1951 (Find. VI, T. 124); notwithstanding that substantially all of the Public Services monies had been received and paid to American Fidelity during the same month of September without Mid-States' knowledge and there could hardly have been time to establish a course of dealing. It is respectfully submitted that where the parties have entered into a written agreement and one of the parties breaches the agreement without notice to the other and without time for the other to learn about it and acquiesce, that it is error to find that there has been "a course of dealing" altering the written agreement (T. 124).

D. ARGUMENT.

1. THE PRINCIPAL IS LIABLE FOR THE ACTS OF THE AGENT.

Under the rule of *respondeat superior* the master is liable for the torts of his servants committed within the scope of their employment, and because the servant is engaged in the master's work and is doing it in place of, or for, the master, the act of the servant is

regarded as the act of the master. *Fernelius v. Pierce* (1943), 22 Cal. 2d 226, 233.

Likewise, representations of an authorized agent are in law the representations of the principal, and where false and fraudulent representations are made by an agent, the principal is equally responsible with the agent since the principal cannot accept the benefits of the transaction and at the same time disclaim liability for fraud which induced a party to enter into the transaction. *Newcomb v. Title Guarantee and Trust Co.* (1933), 131 C.A. 329, 332; *Mathews v. Wilson* (1918), 38 C.A. 148.

In *Ralston Purina Co. v. Novak* (1940), 111 F. (2d) 631, at page 632, the Court said:

> "It is elementary that acts of fraud committed by an agent in the course and scope of his employment are binding upon his principal even though the principal did not know of nor authorize the commission of the fraudulent acts."

In *Jones v. Bankers Life Co.* (1942), 131 F. (2d) 989 at page 993, the Court said:

> "Similarly, we recognize the doctrine that a principal who puts an agent in a position that enables the agent, while apparently acting within his authority, to commit a fraud upon third persons, is subject to liability to such third persons for the fraud of the agent."

The Anglo Bank, in making inquiry of Messrs. Lotz and Smead as to the authority of Mr. Lotz to endorse checks payable to Mid-States had the right to rely upon the representations made to it by Lotz and Smead.

In 23 *Am. Jur.,* page 970, §161, it is stated:

> "The rule is followed at the present time in practically all American jurisdictions in respect of transactions involving both real and personal property, that one to whom a positive, distinct and definite representation has been made is entitled to rely on such representation and need not make further inquiry concerning the particular facts involved. This rule is a corollary to the broad principle of a general right of reliance upon positive statements."

See also *Seeger v. Odell* (1941), 18 Cal. (2d) 409, 414; *Neff v. Engler* (1928), 205 Cal. 484, 489; *Dow v. Swain* (1899), 125 Cal. 674, 683; *Jenness v. Moses Lake Development Co.* (Wash. 1951), 234 P. 2d 865, 869; *Rummer v. Throop* (Wash. 1951), 231 P. 2d 313, 319.

The right of a bank to rely on the representations made to it was recognized in the case of *Lahay v. City National Bank* (Colo. 1890), 25 Pac. 704, where the bank paid on an instrument upon the defendant's representation that the person presenting it was the one named therein. The Court held that the bank may recover the amount paid pursuant to the false representation from the defendant.

In relying on the representations of Messrs. Lotz and Smead (Find. XX, T. 137), the Anglo Bank was deceived and misled to its injury and damage. Had they not told the Bank that Lotz had authority to endorse Mid-States checks, they would not have received the funds represented by those checks and the Bank would not have become indebted to Mid-States

in the sum of $37,500.00 therefor. The defendants, having received $37,500.00 from the Bank because of their false representations, should in law and equity be required to repay the same to the Bank, else they will have been permitted to gain by their own wrongdoing.

The facts clearly show that Mr. Smead was the agent of American Plan and American Fidelity and was acting for, on behalf of and in their interests in representing to the Anglo Bank that Mr. Lotz had authority to endorse checks payable to Mid-States (T. 458, 465, 909; Find. XIV, T. 131, 132). The evidence also shows that American Fidelity actually received the funds from these checks (Find. XIV, T. 130, 131). Having accepted the benefits of the acts of their agents, American Plan and American Fidelity should answer for the consequences of their acts. In requiring American Plan and American Fidelity to return $37,500.00 to Anglo Bank is to require them to do no more than return the money which they would not have received in the first place had it not been for the false representations of their agents, Messrs. Lotz and Smead, made on their behalf, in the course of their agency and in endeavoring to obtain money with which to pay them.

This liability of American Fidelity and American Plan as principals and as beneficiaries of the misrepresentation of their agents exists regardless of whether or not they were part of a conspiracy and of whether or not the moneys they received were trust funds. *Ralston Purina Co. v. Novak,* supra. It is the

consequence of the misrepresentations made to the Anglo Bank. Misrepresentations that were made with knowledge that they were untrue. Having been informed by Mid-States that it would not give authority to endorse its checks there was no way for Messrs. Lotz and Smead to believe they had such authority.

Nor does it matter that the defendants did not think that the Anglo Bank would be exposed to any liability to Mid-States.

In Finding XXIII, T. 139, the trial Court found that the defendants did not "think that Anglo Bank would be exposed to any liability to Mid-States in accepting or acting on such endorsement." What the defendants thought is of no consequence. It is what they did that counts.

In *Wells v. Lloyd IV* (1936), 6 Cal. (2d) 70, 82, the Court said:

> "Under section 3333, Civil Code, the measure of damages for the breach of an obligation not arising from contract is the amount which will compensate for all the detriment proximately caused thereby, *whether it could have been anticipated or not.*"

Consequently, while the defendants may not have thought that the Anglo Bank would be exposed to any liability, their ignorance of the law of the liability of a bank in honoring an unauthorized endorsement is no defense or acceptable answer to the false representations they made to the Bank and which enabled them to obtain funds belonging to Mid-States. Having

made the misrepresentations, it is not their right to say we meant no harm; for they are liable for the natural and direct or proximate consequences of their acts (*Wells v. Lloyd IV,* supra).

Nor can there be any question that the defendants knew that the representations were false. On the day before they opened the account with Anglo Bank Messrs. Lotz and Smead had teletyped to Mr. Hart we "are awaiting authorization required to deposit" (T. 477) and "if we do not receive authorization right away from them (Mid-States) we can have re-issued" (T. 477). Three days before that they had written to Mid-States asking for authority to endorse its checks (T. 287). These are not the acts and statements of persons who believed they had authority to endorse checks payable to Mid-States. On September 5, 1951, and before depositing any of the Public Service checks, or any other check payable to Mid-States, the defendants received written notice from Mid-States denying their request for authority to endorse its checks (T. 289). Since all the checks affecting the Anglo Bank were endorsed after this notice there was no possible way for the defendants to believe they had authority to endorse Mid-States checks. Furthermore, to allay any suspicion that they might have aroused in requesting the authority to endorse, they wrote Mid-States on September 8, 1951, saying that they would not need such authority (T. 291) and notwithstanding such continued to represent to the Anglo Bank that they did have such authority.

2. AMERICAN FIDELITY RECEIVED THE MONEYS FROM LOTZ WITH KNOWLEDGE THAT THEY WERE TRUST FUNDS FOR THE BENEFIT OF MID-STATES.

(a) The moneys were trust funds held by Lotz for the benefit of Mid-States.

There is no dispute that the Public Service checks were made payable to Mid-States and represented premiums for insurance written in Mid-States (Find. XVIII, XXI, Tr. 136, 138). Nor is it disputed that Lotz deposited these checks in his trustee account with Anglo and used the funds to pay his indebtedness to American Fidelity (Find. XIV, T. 130, 131).

By law, funds received by an agent as premiums are trust funds held for the benefit of the insuring company.

California Insurance Code, Section 1730;
17 *Ops. Cal. Atty. Gen.* 1;
Garrison v. Edward Brown & Sons (1944), 25 C. 2d 473;
Maloney v. Rhode Island Ins. Co. (1953), 115 C.A. 2d 238.

However, the trial Court found that the conduct of Lotz and Mid-States modified the trust relationship to the extent that the funds were no longer trust funds (Find. VI, T. 123, 124). In arriving at this conclusion, the Court acknowledged that the new agency agreement of September 1, 1951, between Lotz and Mid-States expressly provided that "all premiums received by the agent shall be held by such agent as trustee for the Company . . ." and "that the premiums received are trust funds" (ibid.)—a provision not contained in the earlier contracts. To offset this

the Court found that the course of dealing between Mid-States and Lotz was not altered after the execution of the new agreement (T. 124).

This conclusion is not supported by the evidence. For the Court also found that the bulk of the Public Service checks were endorsed and paid to American Fidelity within less than three weeks of September 1, 1951 (Find. XVIII, T. 136). Not only was there insufficient time to establish a course of dealing inconsistent with the trust, but during the same three week period Mid-States admittedly twice wrote to Lotz refusing him authority to endorse its checks! And these were the very checks in issue. Nor is there any evidence to show that Mid-States knew during this period that Lotz was violating the new agreement of September 1, 1951.

Without time and without knowledge and acquiescence by Mid-States, clearly no inconsistent course of dealing could be established, and in the absence of any such course of dealing, the law and the contract must determine the nature of the funds to be trust funds.

(b) American Fidelity knew it was being paid with trust funds.

When interrogated about Section 1730 of the California Insurance Code, Mr. Hart, President of American Plan, testified (T. 873):

> "Q. You are familiar with Section 1730 of the Insurance Code which makes it a crime to use premium funds for purposes other than the payment of the account of the company for whom the business is written?
>
> A. I am."

Mr. Hart knew that Mr. Lotz didn't have the money to pay him (T. 832, 844); he was concerned over the indebtedness (T. 838, 845); he knew that the Public Service checks were payable to Mid-States (T. 476, 477); and he knew that American Fidelity was being paid with the Public Service moneys (T. 478, 805). He even testified that at one time he thought of checking directly with Public Service to make sure that the business was being rewritten with Mid-States (T. 807).

In addition to the knowledge Mr. Hart had concerning the source and ownership of the funds being paid to American Fidelity, Mr. Smead concededly knew the source and ownership of all the moneys that were paid to American Fidelity. His knowledge, as the agent of American Plan with full authority over the financial affairs of Mr. Lotz' business (Find. XIV, T. 132), is imputed to his principals, American Plan and American Fidelity.

The law concerning the liability of a person who acquires property with knowledge that its transfer to him constitutes a breach of trust is clear. The rule is stated in 25 *Cal Jur.* 222 as follows:

> "On the other hand, a person who acquires property from another with knowledge that the transferor has merely the legal title, equitable ownership being in a third person, is deemed to hold the land, goods or securities charged with a trust in favor of the equitable owner; and the latter may maintain a suit to establish ownership and compel a transfer of the property. In the language of a recent decision, 'A court of

equity will enforce a trust against all persons who, with notice of the trust, come into possession of the trust property, in the same manner and the same effect as against the original trustee.' If the transferee had knowledge of the trust, it is of no importance that he acted in good faith or without intention of perpetrating a wrong; his motive or intention cannot affect the rights of the equitable owner."

In accord see *Calif. Civil Code,* Section 2243, which provides:

"Everyone to whom property is transferred in violation of a trust, holds the same as an involuntary trustee under such trust, unless he purchased it in good faith, and for a valuable consideration."

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3. AMERICAN FIDELITY, HAVING TAKEN THE PUBLIC SERVICE PREMIUMS WITH NOTICE OF THEIR TRUE OWNERSHIP, HOLDS THEM AS A CONSTRUCTIVE TRUSTEE AND MUST MAKE RESTITUTION.

Even if we assume for the sake of argument that Messrs. Smead and Lotz were not agents of American Fidelity in their dealings with the Public Service checks that were payable to Mid-States, American Fidelity cannot be allowed to benefit by their fraud. It must hold the funds as constructive trustee for the benefit of plaintiffs.

This for the reason that American Fidelity was not a bona fide purchaser: it knew, through Mr. Hart, the president of its managing company, that it was being paid with premiums belonging to Mid-States (T. 805).

The applicable rule is stated in the Restatement of Restitution, Section 167:

> "Where the owner of property transfers it to another, being induced by fraud, duress or undue influence of a third person, the transferee holds the property upon a constructive trust for the transferor, unless before notice of the fraud, duress or undue influence the transferee has given or promised to give value."

Concerning the bona fides of American Fidelity, the controlling principle is that:

> "A person has notice of facts giving rise to a constructive trust not only when he knows them, but also when he should know them; that is when he knows facts which would lead a reasonably diligent and intelligent person to inquire whether there are circumstances which would give rise to a constructive trust, and if such inquiry when pursued with reasonable intelligence and diligence would give him knowledge or reason to know of such circumstances."
>
> Restatement of Restitution, Section 174, comment a;
>
> *Fletcher v. Allen* (1921), 51 Cal.App. 774.

In addition to what Mr. Hart actually knew about the source of the payments to American Fidelity, he certainly had more than ample knowledge to arouse any reasonable person's suspicion that he was being paid with money belonging to others. He concededly knew about the Public Service transaction and about the desperate state of Mr. Lotz's finances. He even

expressed concern by teletype as to how the Public Service checks were made payable (T. 477).

While Mr. Hart testified (T. 763) that he had no concern over the payment of Lotz's indebtedness because of a contemplated loan, the receivables outstanding, and some unearned commissions, the evidence shows that no loan materialized, the receivables were approximately $75,000.00, and regarding the unearned commissions Mr. Hart testified later that he didn't think they would have any bearing (T. 912). Since the indebtedness was $240,000.00, the difference had to come from premiums belonging to other insurance companies.

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4. THE CONSPIRACY.

The Courts recognize the difficulty in proving a conspiracy. In *California Auto Court Assn. v. Cohn* (1950), 98 C.A. 2d 145 at 149, the Court said:

> "Furthermore, because of the inherent difficulty in proving a conspiracy, it has been held that a conspiracy may sometimes be inferred from the nature of the acts done, the relations of the parties, the interests of the alleged conspirators, and other circumstances."

Despite the refusal of the trial Court to find a conspiracy and to credit the written statements of Messrs. Lotz and Smead the following remain uncontradicted and admitted by Mr. Hart:

(1) Mr. Hart was concerned over payment of Lotz' indebtedness and called him and Mr. Smead to New York.

(2) Mr. Lotz owed American Fidelity approximately $240,000.00 (T. 762).

(3) Mr. Lotz did not have the money to pay American Fidelity.

(4) Writing of insurance in Mid-States was discussed at the New York meeting (T. 764).

(5) Mr. Lotz did call Mid-States from Mr. Hart's office (T. 765).

(6) A week after the New York meeting Mr. Hart did come to Oakland (T. 772).

(7) Mr. Hart did know about the Public Service transactions (T. 773).

(8) Mr. Hart did know that the Public Service checks were payable to Mid-States.

(9) Mr. Hart did want to keep Mr. Lotz in business (T. 904) and testified, "I was interested in keeping Mr. Lotz in business to collect our money."

(10) Mr. Hart did credit Mr. Lotz' account with $38,000 so that if any one inquired about Mr. Lotz his company could say that he was current with them (T. 903).

(11) Mr. Smead did get approval from Mr. Hart to make a payment on September 15, 1951, to Mid-States (T. 783).

(12) American Fidelity was paid with premiums on insurance written in Mid-States.

(13) Mr. Hart hired Mr. Smead and ultimately appointed him Pacific Coast Manager for his company, all the while knowing about the statements and charges Mr. Smead had made accusing him of the conspiracy.

Short of additional confessions what more could the plaintiff show? The purpose or motive, the necessity and the actual accomplishment in the manner alleged are all admitted, to which is added the peculiar circumstance of the employment of Mr. Smead by the very persons he accuses of the conspiracy.

E. CONCLUSION.

(1) Messrs. Lotz and Smead as agents, and American Plan and American Fidelity as principals, are responsible to the Anglo Bank for the damage it has sustained because of the false representations and statements that Lotz had authority to endorse Mid-States' checks. This is so regardless of whether or not there was a conspiracy.

(2) American Fidelity and American Plan, having benefited because of the false representations and statements of their agents to the detriment of Anglo Bank, should be required to reimburse Anglo Bank; otherwise they would be unjustly enriched.

(3) American Fidelity and American Plan knowing that the Public Service monies were trust funds belonging to Mid-States could not receive them in

good faith and must hold them in trust: $37,500 for the Anglo Bank and the balance for Mid-States.

(4) All the elements of a conspiracy, short of a confession from all parties, were established.

Dated, San Francisco, California,
September 12, 1955.

Respectfully submitted,
SEVERSON, MCCALLUM & DAVIS,
ALMON B. MCCALLUM,
NATHAN R. BERKE,
Attorneys for Appellant, The Anglo California National Bank of San Francisco.